

THE ALABAMA TRUST FUND

The State's Most Valuable Financial Asset

EXECUTIVE SUMMARY

FOR FISCAL YEAR 2018

The Alabama Trust Fund (ATF) experienced another solid investment performance for the fiscal year ending September 30, 2018. Here are the highlights:

- The investment portfolio generated a rate of return of 6.99%.
- The investment portfolio grew to \$3.24 billion, a \$98 million, or 3%, increase over the previous year.
- The ATF distributed \$163.1 million in support of its recipients (see page 2).

The main components of the ATF accounting structure are the incoming oil and gas capital payments and investment earnings, outgoing distributions and the investment portfolio.

For fiscal year 2018, the ATF generated \$251.6 million in revenues from investment income, realized gains, and oil and gas capital payments. Expenditures were largely comprised of the \$163.1 million constitutionally required distributions, and \$10.2 million in professional fees.

At September 30, 2018, trust assets were approximately \$3.24 billion in eligible investments of trust fund monies and \$242 million in land acquired under the Alabama Forever Wild Land Trust for a total of almost \$3.5 billion.

The year 2012 marked the restructuring of the Alabama Trust Fund through the passage of constitutional amendment 856. With this restructuring the ATF is now properly designed to receive royalties, invest them prudently and distribute assets from the trust promptly and predictably to the designated beneficiaries. The changes that were made brought the ATF into the 21st century and the effect is a renewal of the ATF's significant financial impact on the state.

The financial information provided in this report confirms the improvement in the ATF. The process has worked, is working and certainly will work into the future. It is imperative that the ATF stay the course to produce the best possible outcome for the State and its citizens.

At the end of the 2018 fiscal year, Sam Upchurch, Chairman of the Board of Oakworth Capital Bank, concluded his service on the board. Sam brought extensive investment expertise to the board and served faithfully on the Investment Committee. Given that the ATF funds and invests for Forever Wild, his nature conservancy experience and love for the outdoors was an insightful bonus. We appreciate Sam's and the entire Board's dedication to keeping the ATF as the State's most valuable financial asset.

ATF ANNUAL HISTORICAL REPORT (unaudited)

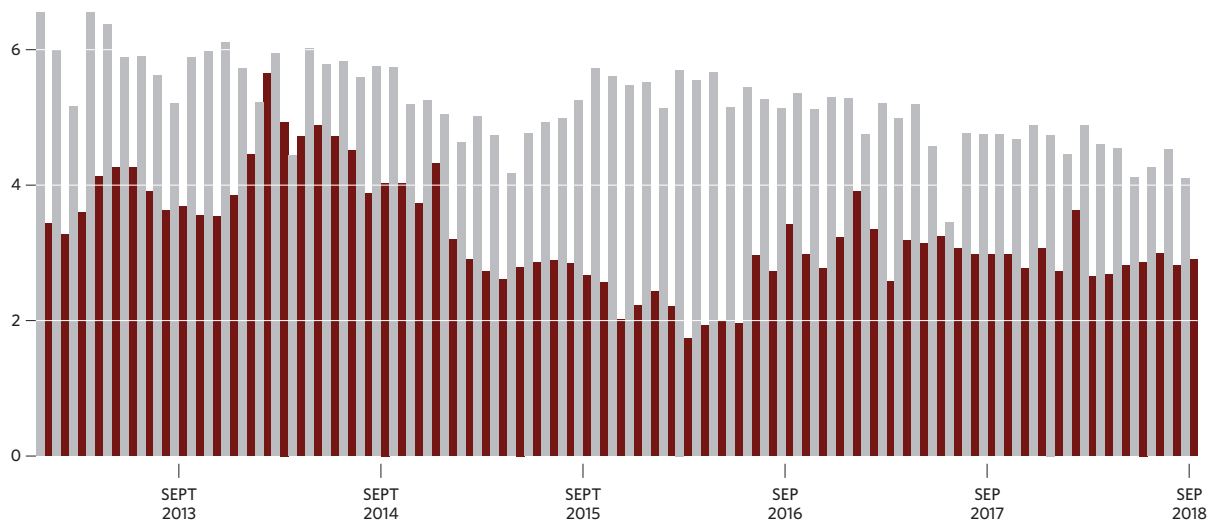
in millions

	FY14	FY15	FY16	FY17	FY18
Inflows					
Royalties	\$88.1	61.4	43.4	47.7	47.7
Income	190.9	124.1	92.1	195.6	203.9
Total Inflows	\$279.0	185.5	135.5	243.3	251.6
Transfers from the Alabama Trust Fund					
General Fund	\$103.8	100.9	103.3	98.0	96.8
Forever Wild	15.0	14.6	15.0	14.2	14.0
Cities	15.0	14.6	15.0	14.2	14.0
Counties	15.0	14.6	15.0	14.2	14.0
Senior Services	1.5	1.5	1.5	1.4	1.4
State Lands (1% of royalties)	0.9	0.6	0.4	0.5	0.5
Ala. Capital Improvement Trust Fund	23.0	24.4	17.0	13.4	19.4
County Municipal Trust Fund	5.8	6.1	4.3	3.0	3.3
General Fund (Amendment 856 minus repayment)	141.0	136.0	N/A	N/A	N/A
Total Transfers	\$321.0	313.3	171.5	158.9	163.1
Amendment 856 withdrawals	\$146.0	146.0	0.0	0.0	0.0
Repayments from General Fund	(5.0)	(10.0)	0.0	(238.4)	0.0
Net Total Transfers from the Alabama Trust Fund	\$321.0	313.3	171.5	(79.5)	163.1

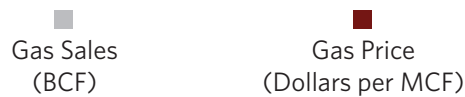
Annual transfers from the ATF to the General Fund are 5% of the 3-year rolling average of the value of the invested assets plus 33% of the annual royalties. This amount declined during the period FY13-FY17 due to the significant Amendment 856 withdrawals. The asset growth and repayments in FY17 began the reversal of that trend.

OIL AND GAS PAYMENTS

Oil and gas capital payments are defined as “any royalty or other payment, with the exception of any taxes, heretofore or hereafter levied that is based upon or determined with respect to the production of oil, gas, or other hydrocarbon minerals and that is paid to the state” The amount of the payments is dependent on two components: natural gas volumes and the price of natural gas per thousand cubic feet (Mcf). For the Alabama leases there is an assumed 8.4% annual decline rate projected by the Alabama Oil and Gas Board. Recent results reflect and confirm this declining revenue trend. For example, in FY2013, the ATF received \$83 million in royalties. In 2018, the ATF received \$47.7 million in royalties.



Alabama State Waters Gas Sales & Price

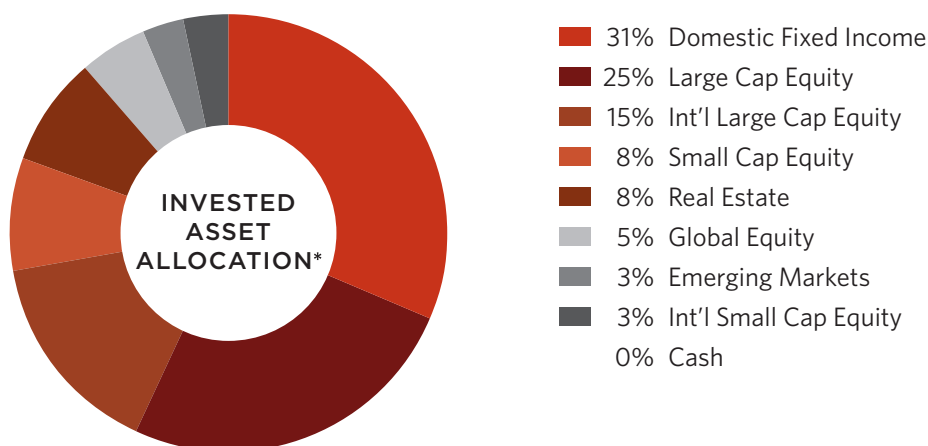


INVESTMENT PORTFOLIO

In reliance on prudent standards for preservation of capital and maintenance of liquidity, the Board's investment portfolio objective is to earn the highest possible total rate of return consistent with defined tolerances for risk and sufficient to fund the required distributions. The ATF has a long-term investment horizon with asset allocation and diversification being the primary determinants of positive investment performance.

Invested Assets Annual Rate of Return								
Fiscal Year	2012	2013	2014	2015	2016	2017	2018	7 YR AVERAGE
Rate of Return	12.95%	9.08%	8.48%	-0.09%	10.61%	11.55%	6.99%	8.51%

INVESTED ASSET ALLOCATION as of SEPTEMBER 30, 2018



SUPPLEMENTAL INFORMATION

HISTORY AND STRUCTURE OF THE ATF

Beginning in the late 1950s several U.S. States established sovereign wealth funds, also known as permanent trust funds, to capitalize on their natural resources to enhance the revenues of the state. They were designed to be intergenerational, thus providing revenues and wealth across many generations. The State of Alabama created such a fund with revenues from offshore gas production flowing into what is known today as the Alabama Trust Fund for the continuing benefit of the State and its citizens. The ATF plays an important role in the financial wellbeing of Alabama. It must be managed prudently and protected properly to fulfill that goal.

The discovery of natural gas in Mobile Bay in 1978 led to active drilling and development of the large gas reserves below Alabama's coastal waters. The State received bids in 1981 for the rights to develop offshore tracts. In 1982, Alabama voters approved the creation of the Alabama Heritage Trust Fund (AHTF) that would receive the \$347 million in proceeds from the first sale of drilling rights in 1984.

In 1985, voters approved Amendment 450 to the Constitution of the State of Alabama creating the Alabama Trust Fund as an irrevocable, permanent trust fund for the continuing benefit of the State of Alabama and its citizens. Oil and gas capital payments from offshore gas production were directed into the ATF. The initial principal of the ATF was \$333 million. In December 2001, the AHTF transferred \$467 million in trust capital to the ATF as directed by Amendment 450.

The Board of Trustees of the ATF is responsible for the possession, control and management of the trust fund. The board is comprised of nine trustees consisting of the Governor, the State Treasurer, the Director of Finance, three trustees appointed by the Governor, two trustees appointed by the Lieutenant Governor, and one trustee appointed by the Speaker of the House of Representatives. The Governor, State Treasurer and Director of Finance each serve as a trustee ex officio and as an officer.

Board of Trustees and Officers

Kay Ivey, Chair, Governor of Alabama
 Kelly Butler, Vice Chair, Acting Alabama Director of Finance
 Young Boozer, Secretary, Alabama State Treasurer
 John Hornsby, appointed by the Governor
 Daniel Hughes, appointed by the Lt. Governor
 Edgar Pruitt, appointed by the Governor
 Sandra Sims-deGraffenried, appointed by the Speaker of the House
 Guice Slawson, Jr, appointed by the Lt. Governor
 Sam Upchurch, appointed by the Governor

Additional information on the Alabama Trust Fund can be found on the State Treasurer's website, treasury.alabama.gov/alabama-trust-fund. It includes this annual report, agendas and documentation from quarterly Board meetings, and supplemental reports concerning the ATF and its activities.

DISTRIBUTIONS

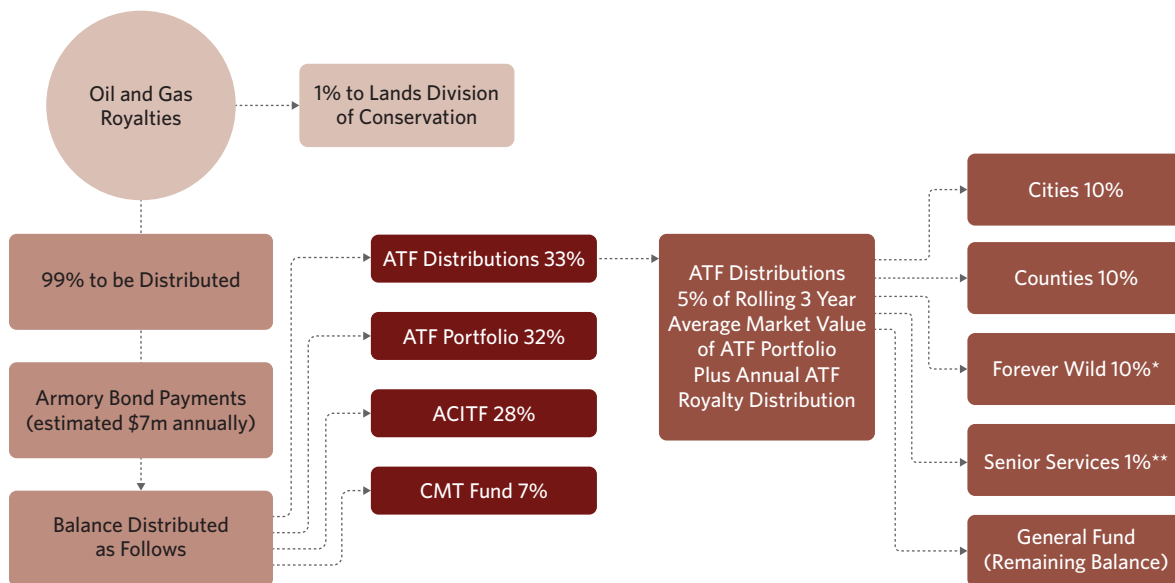
Over the years, various constitutional amendments have determined the distributions and recipients from revenues of the ATF.

Oil and gas capital payments received are annually distributed from the ATF as follows:

Distribution	Recipient
33%	Cities, Counties, Forever Wild Land Trust, Alabama Senior Services, General Fund
28%	Alabama Capital Improvement Trust Fund
7%	County and Municipal Government Capital Improvement Trust Fund
1%	Alabama Department of Conservation and Natural Resources
As necessary	Alabama National Guard Armory bond debt service payment
Remainder	ATF

Additionally, 5% of the rolling 3-year average market value of invested assets of the ATF are distributed to the cities, counties, Forever Wild Land Trust, Alabama Senior Services Trust Fund, and General Fund.

ATF CASH FLOWS



* FWLT Distributions capped at \$15 million annually

** Senior Services capped at \$5 million annually

SUMMARY OF REPAYMENTS DUE TO THE ATF

Under House Bill 36 passed in the 2016 Legislative Special Session, the General Fund is scheduled to make the following repayments to the ATF:

Fiscal Year	Amount
2021	\$13,500,000
2022	\$13,500,000
2023	\$13,500,000
2024	\$13,500,000
2025	\$13,500,000
2026	\$13,500,000
2027	\$13,500,000
2028	\$13,500,000
2029	\$13,500,000
2030	\$13,500,000
2031	\$13,500,000
2032	\$13,500,000
2033	\$8,456,703
TOTAL	\$170,456,703

SUMMARY OF THE AMENDMENTS AND ACTS OF THE ATF

Amendment 450 — passed in 1985

- Created the Alabama Trust Fund as an irrevocable, permanent trust fund
- Terminated the Heritage Trust Fund in 2001 and transferred trust capital to the ATF

Section 11-66, Code of Alabama — passed in 1986

- Created the Municipal Government Capital Improvement Fund
- Allowed at such time that ATF trust income equaled or exceeded \$60 million in the preceding fiscal year the General Fund must pay 10% to this fund to be distributed by the State Comptroller

Section 11-29, Code of Alabama — passed in 1986

- Created the County Government Capital Improvement Fund
- Allowed at such time that ATF trust income equaled or exceeded \$60 million in the preceding fiscal year the General Fund must pay 10% to this fund to be distributed by the State Comptroller

Amendment 488 — passed in 1988

- Allowed the Heritage Trust Fund and the Alabama Trust Fund to invest in such investments as allowed by law for the Retirement Systems of Alabama
- Allowed capital gains from the sales of investments to become part of trust fund capital

Amendment 543 — passed in 1993

- Created the Forever Wild Land Trust for the purpose of acquiring, maintaining and protecting unique land and water areas within the State
- Redirected the percentage of ATF income currently being retained by the ATF to be distributed to the Forever Wild Land Trust

Amendment 666 — passed in 2000

- Redistributed 35% of Oil and Gas capital payments
- Created the County and Municipal Government Capital Improvement Trust Fund and the Alabama Capital Improvement Trust Fund
- Allowed for the transfer of up to 75% of the realized and unrealized capital gains on sales of investments other than fixed income to the General Fund
- Directed that the Secretary-Treasurer of the Retirement Systems of Alabama shall be the initial manager of 50% of the ATF assets

Amendment 709 — passed in 2002

- Created the Education Trust Fund Rainy Day Account

Amendment 803 — passed in 2008

- Repealed Amendment 709
- Re-established the Education Trust Fund Rainy Day Account
- Created the General Fund Rainy Day Account

Amendment 856 — passed in 2012

- Provided new procedure for ATF distributions
- Provided distributions from the County and Municipal Government Capital Improvement Trust Fund
- Transferred \$145,796,943 annually to the General Fund for fiscal years 2013, 2014 and 2015
- Repealed laws in conflict with the amendment

Amendment 887 — passed in 2014

- Increased the total amount of bonding authority granted under Amendment 666
- Provided for additional payments from the ATF oil and gas capital payments to fund debt service on armory bonds issued
- Provided for the use of the bond proceeds for plans, construction and maintenance of Alabama National Guard armories



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